

The Law on Ultra Vires Acts and Contracts of Private Corporations

Frank A. Mack

Follow this and additional works at: <http://scholarship.law.marquette.edu/mulr>



Part of the [Law Commons](#)

Repository Citation

Frank A. Mack, *The Law on Ultra Vires Acts and Contracts of Private Corporations*, 14 Marq. L. Rev. 212 (1930).
Available at: <http://scholarship.law.marquette.edu/mulr/vol14/iss4/4>

This Article is brought to you for free and open access by the Journals at Marquette Law Scholarly Commons. It has been accepted for inclusion in Marquette Law Review by an authorized administrator of Marquette Law Scholarly Commons. For more information, please contact megan.obrien@marquette.edu.

THE LAW ON ULTRA VIRES ACTS AND CONTRACTS OF PRIVATE CORPORATIONS

By FRANK A. MACK*

ULTRA VIRES ACTS AND CONTRACTS OF CORPORATIONS

A CORPORATION is an artificial being independent of members that compose it, existing by law and because of law, and is capable of contracting, suing and being sued in its name, having a residence, having an intent, malice, and a perpetual succession.¹

DOCTRINE OF ULTRA VIRES

The term "ultra vires," in its proper sense, "denotes some act or transaction on the part of a corporation which, although not unlawful or contrary to public policy if done or executed by an individual, is yet beyond the legitimate powers of the corporation as they are defined by the statutes under which it is formed, or which are applicable to it, or by its charter or incorporation papers." 2 Machen, Corp. Sec. 1012.

In considering the cases in which the law applicable to corporations is discussed, it must be borne in mind that there are several classes of rights to which they apply, and that upon the same state of facts, the legal consequences might be different with reference to the different classes of rights. Thus there are corporate rights which pertain to the corporation as an artificial legal entity, in other words, a distinct person; individual rights of the stockholders, and rights of the creditors of the corporation. The rights of strangers dealing with the corporation will vary according as they are considered with reference to the corporation itself, the stockholders, or the creditors of the corporation. The stockholders and those dealing with the corporation are the only parties directly interested in their acts, so long as the corporation confines itself within the general scope of its powers. The rights of the corporation, and of strangers dealing with the corporation, may in some respects, vary according to the circumstances surrounding a given transaction.

As to the exact nature of an ultra vires act, the decisions are conflicting. Some courts regard an ultra vires act as they would an illegal act, while others regard it as a mere nullity. Still others regard it as

* Member of the Milwaukee Bar.

¹ Professor Lang's definition.

perfectly valid and binding unless the sovereign state sees fit to interfere. An act is said to be *ultra vires* when it is not within the scope of the powers of the corporation to perform it under any circumstances or for any purpose. An act is also sometimes said to be *ultra vires* with reference to the rights of certain parties, when the corporation is not authorized to perform it without their consent, or with reference to some specific purpose, when it is not authorized to perform it for that purpose, although fully within the scope of the general powers of the corporation, with the consent of the parties interested or for some other purpose. And the rights of third persons dealing with corporations may vary, according as the act is *ultra vires* in one or the other of these senses. These distinctions must be borne in mind in considering a question arising out of dealings with a corporation. When an act is *ultra vires* in the first sense mentioned, it is generally void in toto, and the corporation may avail itself of the plea. But when it is *ultra vires* in the second sense, the right of the corporation to avail itself of the plea will depend upon the circumstances of the case.

The question, as between stockholders and the corporation, is a different one from that which arises between the corporation itself and third persons dealing with it, and the principle established by the courts in their decisions where the suit arises between third persons and the corporation is, whether the act in question is one which the corporation is not authorized to perform under any circumstances, or one that may be performed by the corporation for some purposes, but may not for others. In the former case the defense of *ultra vires* is available to the corporation as against all persons, because they are bound to know from the law of its existence that it has no power to perform the act. But in the latter case the defense may or may not be available, depending upon the question whether the party dealing with the corporation is aware of the intention to perform the act for an authorized purpose, or under circumstances not justifying its performance. The test as between third persons having no knowledge of an unlawful purpose and the corporation, is to compare the terms of the contract with the provisions of the law from which the corporation derives its powers, and if the court can see that the act to be performed is beyond the powers of the corporation for any purpose, the contract cannot be enforced, otherwise it can. Using the language of Mr. Justice Selden:

"Where the want of power is apparent, upon comparing the act done with the terms of the charter, the party dealing with the corporation is presumed to have knowledge of the defect, and the defense of *ultra vires* is available against him. But such a defense

would not be permitted to prevail against a party who cannot be presumed to have had any knowledge of the want of authority to make the contract. Hence, if the question of power depends not merely upon the law under which the corporation acts, but upon the existence of certain extrinsic facts resting peculiarly within the knowledge of the corporate officers, then the corporation would, I apprehend, be estopped from denying that which (by assuming to make the contract), it had virtually affirmed."²

Third persons are presumed to know the law of the land, and they are bound, when dealing with the corporations, to know the powers conferred by their charter. These are open to their inspection, and it is easy to determine whether the act is within the scope of the general powers for that purpose. But they have no access to the private papers of the corporation, or to the motives which govern directors and stockholders, and no means for knowing the purposes for which an act, that may be lawful for some purposes, is done. The very fact that the appointed officers of the corporation assume to do an act in the apparent performance of their duties which they are authorized to perform for the lawful purposes of the corporation, is a representation to those dealing with them that the act performed is for a proper purpose. Such is the presumption of the law, and upon this presumption, third persons having no notice in fact of the unlawful purposes, are entitled to rely.³

Upon any other principle there would be no safety in dealing with corporations, and the business operations of these institutions would be greatly crippled, while the interests of the stockholders and the public, and their general usefulness would be seriously impaired. The officers are appointed by the corporation and if any loss results to third persons dealing with the corporation from their misrepresentation in matters within the general scope of their duties, it should fall upon the corporation, which is responsible for their appointment, rather than upon parties who have no other means of ascertaining the facts, and must rely upon their assurances or not deal with the corporation at all.

ULTRA VIRES DISTINGUISHED FROM ILLEGALITY

An ultra vires act is not necessarily an illegal act. The two are not the same. Much of the confusion in the decisions has arisen from the failure to distinguish between the two. An ultra vires act may

² 22 N.Y. 290 *Bissell v. The Michigan Southern and Indiana Railroad Company* (1853).

³ *Bank of United States v. Danbridge*, 12 Wheat 64.

also be an illegal act. The two overlap but they are not the same. For example: Suppose that a corporation organized to manufacture automobiles contracts to provide homes for its employees. This act would not be illegal nor is it forbidden by statute; it is simply an unauthorized act. The automobile manufacturing corporation is doing something which is ultra vires and quite unauthorized by the terms of its charter, but it is doing nothing illegal. The contract is neither *malum prohibitum* or *malum in se*. On the other hand, suppose that a corporation organized to operate a department store engages a gangster to murder a competing rival. The gangster murders the competitor. This contract is not only ultra vires of the department store, but it is illegal as well. The distinction between the two, (ultra vires on the one hand, and illegality upon the other), seems obvious. The distinction is of great importance from the practical point of view. The law is well settled that there never can be a recovery upon an illegal contract. As an ultra vires contract is not necessarily an illegal one, the rules which are applicable to illegal contracts are not at all decisive in the cases of ultra vires.⁴

ULTRA VIRES CONTRACTS

The doctrine of ultra vires has been thoroughly discussed within the last thirty years, and its extent and limitations clearly defined. Two propositions are settled.⁵ One is that a contract by which a corporation disables itself from performing the functions and duties undertaken and imposed by its charter is, unless the state which created it consents, ultra vires. A charter not only grants rights, but it also imposes duties. An acceptance of those rights is an assumption of those duties. Since it is a contract which prevents the state from interfering with those rights, so it is one which binds the corporation not to abandon the discharge of those duties. It is a contract whose obligations neither the state nor corporation can abandon, without the consent of the other.

The second is that the powers of a corporation are such as its charter confers, and an act beyond the measure of those powers is ultra vires. A corporation has no natural or inherent rights or capacities. Since the corporation is a creature of the state, it has such powers as the state has seen fit to give it, and nothing more. Consequently, when it assumes to do that which it has not been empowered by the state to do, its assumption of power is in vain, and the courts will

⁴ *Ashbury Railway Carriage and Iron Company v. Riche*, 9 Ex. 224, 7H.L. 653.

⁵ *Central Transportation Company v. Pullman's Palace Car Company*, 139 U. S. 24, Sup. Ct. Rep. 478 (1891).

construe such an act a nullity, and the contract is ultra vires. These two propositions embrace the whole doctrine of ultra vires.

The reasons why a corporation is not liable upon a contract ultra vires, which is beyond the powers conferred upon it by the legislature, and varying from the objects of its creation as declared in the law of its organization are:

First: The interest of the public, that the corporation shall not transcend the powers granted.

Second: The interest of the stockholders, that the capital shall not be subjected to the risk of enterprises not contemplated by the charter, and therefore not authorized for the stock.

Third: The obligation of everyone, entering in a contract with a corporation, to take notice of the legal limits of its powers.^{5½}

These three reasons are clearly brought out in the unanimous judgment of the United States Supreme Court, delivered by Mr. Justice Campbell, in the leading case of *Pearce v. Madison and Indianapolis Railroad*, 21 How, 441, in which it was held that a railroad corporation was not liable to be sued upon promissory notes which it had given in payment for a steamboat received and used by it, and running in connection with its railroad.

In Wisconsin a corporation cannot enforce a contract not authorized by its charter.⁶ Nor can one made by it for an unauthorized purpose be enforced against it.⁷ But one within its general and unrestricted powers is valid.⁸ A corporation having, within its authority under its charter, guaranteed the debts of other parties, and having paid such debt on default of the principal debtors, cannot enforce the securities given to it by the latter parties to indemnify it for making such guaranty.⁹

A corporation is not only incapable of making contracts which are forbidden by its charter, but, in general, it can make none which are not necessary either directly or indirectly to effect the objects of its creative, and a contract made by a corporation, which is entirely foreign to the purposes of its creation, is void.¹⁰ While contracts made

^{5½} *Central Transportation Company v. Pullman's Palace Car Company*, 139 U.S. 24, 11 Sup. Ct. Rep. 478 (1891).

⁶ *Madison, W. & M. Plank Road Company v. Watertown and Plank Road*, 7 Wis. 59 (1873); *Rock River Bank v. Sherwood*, 10 Wis. 230 (1860).

⁷ *Northwestern Union Packet Company v. Shaw*, 35 Wis. 655 (1874).

⁸ *Wausau Boom Company v. Plumer*, 35 Wis. 274 (1884).

⁹ *Madison, W. & M. Plank Road Company v. Watertown and Plank Road*, 7 Wis. 59 (1859).

¹⁰ *Rock River Bank v. Sherwood*, 10 Wis. 230 (1860).

by corporations, which they have no authority to make, may be void, yet those which are within the general scope of their powers will be valid, although in some particulars in excess of those powers, unless by reason of such excess they are against public policy.¹¹

EXECUTORY CONTRACTS

Where a contract is purely executory: that is, where nothing had been done by either party, there cannot be any recovery either by or against the corporation for breach of an ultra vires contract. A mere executory ultra vires contract can never be made the foundation of an action either by or against the corporation. In a famous decision by the Supreme Court of the United States, a corporation sought to obtain in equity the specific performance of a contract to convey lands to it. In deciding against the corporation, on the ground that the contract still remained unexecuted, Mr. Justice Miller said: "While a court might hesitate to declare the title to land already received and in the possession and ownership of the company void on the principle that they had no authority to take such lands, it is very clear that it will not make itself the active agent of the company in violating the law and enabling the company to do that which the law forbids."¹² The minority holds that even an executory contract can only be attacked by the state.

The theory upon which our courts refuse to sanction a recovery upon an executory ultra vires corporate contract is very simple. After all, a corporate contract which is ultra vires is an unauthorized contract and one which the state had not permitted or sanctioned. Therefore, the courts, which are the agency of the state, should not lend their aid in order to carry out such a contract which is still wholly unexecuted. For example, suppose that a retail grocery corporation has agreed to purchase several thousand yards of silk from X. The corporation refuses to take the silk when X delivers it on the ground that it is unauthorized to enter into such a contract. The contract is entirely executory. The courts are practically unanimous in holding that X cannot recover damages from the corporation. Take the reverse situation. Suppose that X refuses to deliver the silk to the corporation. The grocery corporation cannot sue and recover damages for the breach of the contract. In other words, the courts will not lend their aid in order to enable parties to effectuate an ultra vires contract. In fact, it is the duty of either party to withdraw from such

¹¹ *Germantown Farmers' Mutual Insurance Company v. Dhein*, 43 Wis. 420 (1878).

¹² *Case v. Kelly*, 133 U.S. 21 (1890).

a contract, and when this is done no action for breach of contract will lie at law, and in equity specific performance will not be decreed.¹³

The reasons why a corporation cannot sue or be sued upon such an ultra vires contract are stated above.

EXECUTED CONTRACTS

Just as the court will not interfere with executory ultra vires contracts, so it will not interfere with ultra vires contracts when fully executed by those parties. It will not disturb such an executed contract upon the complaint either of the corporation or the other contracting party, but the court will leave the parties in status quo—that is, where they have placed themselves by their own actions and where it finds them. In *Long v. Georgia Pacific Railroad Company*, 91 Ala. 519, 8 So. 706 (1890), Long and his wife executed to the railway company a deed of certain valuable mineral interests in the land. The bill sought to have the deed declared void because of this incapacity of the corporation, and to have it cancelled as a cloud upon Long's title. The corporation demurred. The court decided that, as the contract was duly executed on both sides, it would not interfere. McClellan, Justice, said: "The law will not interfere, at the instance of either party, to undo that which it was originally unlawful to do, and to the doing of which, so long as the contract to that end remained executory, neither party could have coerced the other." The court left the parties where they had placed themselves.

PARTIALLY EXECUTED CONTRACTS

Where a contract has been partially executed, there are two views as to its legal effect. The rule maintained in the Supreme Court of the United States is that an ultra vires contract is absolutely null and void, and that no action in any form can be maintained upon the contract itself.¹⁴ It is followed by a few, but rejected by most of the State courts. In New York and in the majority of the state courts, the rule is that if the contract is partially executed, the party who has performed on his part may sue and recover upon the contract, and the other party is estopped from denying the validity of the agreement. This rule is followed by the Wisconsin Supreme Court.¹⁵

¹³ *Nassau Bank v. Jones*, 95 N.Y. 115 (1884); *Chicago Ry. Co. v. Union Pacific Railroad Company*, 47 Fed. 15 (1891).

¹⁴ 131 U.S. 371 *Pittsburg, Cincinnati and St. Louis Railway Company* (1889).

¹⁵ *McElroy v. Mim Percheron Horse Company*, 96 Wis. 317 (1897); *Security National Bank v. St. Croix Power Company*, 117 Wis. 211 (1920); *Witter v.*

Suppose that a gun manufacturing corporation orders several railroad box cars from a car manufacturing corporation. In the federal courts, the car corporation could not sue and recover from the gun corporation the agreed price of the cars. In other words, the car corporation would have no remedy upon the contract itself. Whatever remedy the car corporation would have would be in an action on quasi-contract to recover the reasonable value of the cars from the gun corporation and to prevent the unjust enrichment of the gun corporation at the expense of the car corporation. But in New York, and in Wisconsin the car corporation would be allowed to recover the agreed purchase price of the cars in an action brought against the gun corporation for breach of contract. The gun corporation, having received the benefits of the contract, would be estopped from raising the defense that it was unauthorized by its charter to purchase cars of that sort. The New York and Wisconsin courts say that the gun corporation should not be privileged to say that it is without authority where it has received and retained the benefits of the contract. Consequently, in New York, Wisconsin, and some of the other jurisdictions, the partially executed ultra vires contract is unquestionably enforceable, according to its terms, by the party who has performed on its part.

The federal is commonly known as the strict rule. In the federal courts the view is taken that there can never be a recovery upon the contract itself. As was said by Mr. Justice Gray in a leading case:¹⁶

"All contracts made by a corporation beyond the scope of its powers are unlawful and void, and no action can be maintained upon them in the courts upon three distinct grounds," which were stated above. A contract which is unlawful and void because beyond the scope of the corporate powers does not become lawful and valid by being carried into execution. No action, under any circumstances, can be maintained upon the unlawful or according to its terms. So where a railroad corporation acted in excess of its powers and leased all of its property to another railroad corporation, the court would hold that the lessor could not recover the rentals which had accrued under the contract.

In the example given above, what would be the remedy of the lessor corporation? The Supreme Court of the United States would answer that the lessor corporation should disaffirm the contract of lease and sue to recover on a *quantum meruit*, which would constitute the rea-

Milling Company, 78 Wis. 543 (1891); *Bigelow v. R. Company*, 104 Wis. 109, (1899); *Eastman v. Parkinson*, 133 Wis. 375 (1907); *Lewis v. Amer. Savings & Loan Association*, 98 Wis. 283 (1898).

¹⁶ *Central Transportation Company v. Pullman's Palace Car Company*, 139 U.S. 24, 35 L. Ed. 55 (1891).

sonable value of what the defendant corporation has actually received the benefit of. To maintain such action the lessor corporation would have to disaffirm the ultra vires contract.

The court recognizes that there can be no recovery upon the contract itself. But, in order to do justice between the parties, it permits property or money parted with on the faith of the unlawful contract, to be recovered back, or compensation paid for same. This the court permitted to be done in another leading case.¹⁷

It is plain that the federal courts, while they do not permit a recovery upon the contract itself, nevertheless they recognize that a party should not receive and retain property without making adequate compensation for it, and permit the party to resort to the doctrine of quasi-contract, in which a promise is implied and a recovery can be had for the reasonable value of that which has been received and retained.

The New York and the Wisconsin rule is commonly known as the liberal rule. In New York, Wisconsin, and many other jurisdictions, one who has received from a corporation the full consideration of his promise cannot avail himself of the objection that the contract fully performed by the corporation was ultra vires, not within its chartered powers. The New York courts insist that it would be contrary to the first principles of equity to allow such a defense to prevail in an action by the corporation. In a leading case,¹⁸ a corporation entered into a contract with a corporation organized to manufacture firearms and other implements of warfare, to furnish to it twenty thousand railroad locks. The plaintiff, the firearms corporation, made and delivered ten thousand locks under the contract and as to the residue the contract was rescinded by mutual consent. It was conceded that the manufacturing and selling of railroad locks was not within the purposes for which the firearms corporation was incorporated, or within the powers conferred upon it by its charter. Yet it was unanimously held that the plea of ultra vires could not prevail because the defendant corporation has received the full benefit of the contract. Mr. Justice Allen said: "It is now very well settled that a corporation cannot avail itself of the defense of ultra vires when the contract has been, in good faith, fully performed by the other party, and the corporation has had the full benefit of the performance and of the contract. * * * The same rule holds converso. If the other party has had the benefit of the contract fully performed by the corpora-

¹⁷ *Pullman's Palace Car Company v. Central Transportation Company*, 171 U.S. 138, 43 L. Ed. 108 (1897).

¹⁸ *Whitney Arms Company v. Barlow*, 63 N.Y. 62 (1877).

tion, he will not be heard to object that the contract and performance were not within the legitimate powers of the corporation."

In other words: the party who has had the benefit of the ultra vires contract cannot be permitted to question its validity in an action upon it.¹⁹

Then we also have the rule commonly known as the intermediate rule between the Federal rule, known as the strict rule and New York and Wisconsin rule, known as the liberal rule. This rule prevails in several jurisdictions, including Illinois, in which the courts draw a distinction between want of power, on the one hand, and abuse of power, on the other. There is an absolute want of power to make the contract, they hold that there can never be any recovery upon the agreement itself. As was said by Chief Justice Cartwright, of the Supreme Court of Illinois: "It would be contradictory to say that a contract is void for an absolute want of power to make it, and yet it may become a legal and valid contract by way of estoppel, through some other act of the party under some incapacity, or some act of the other party chargeable by law with notice of the want of power."²⁰

On the other hand, where there exists only an abuse of power and the act is within the general scope of the corporate powers, the Illinois courts apply the doctrine of estoppel as applied in New York.

It would be difficult to make a line of demarkation between want of power and abuse of power. In my opinion the distinction is of questionable value. If the Illinois rule confines the doctrine of estoppel to those cases where the contract is within the powers of the corporation, but only beyond the mere authority of its officers or agents, the rule will be more readily understood by the student. But gathering from the decisions of the Illinois courts, the rule is not confined within these limits.

ACQUISITION OF PROPERTY

Suppose that a corporation takes a conveyance of real estate which is unauthorized by its charter. The question to determine is: Is the conveyance to the corporation void? The courts are practically unanimous in answering this question in the negative. Mr. Justice Hughes in a recent decision by the Supreme Court of the United States²¹ said: "In the absence of a clear expression of legislative intention to the contrary, a conveyance of real estate to a corporation for a pur-

¹⁹ *Bath Gas Light Company v. Claffy*, 151 N.Y. 24, 45 N.E. 390 (1896).

²⁰ *National Home Building v. Loan Association Home Savings Bank*, 181 Ill. 35, 54 N.E. 619 (1899).

²¹ *Kerfoot v. Farmers' and Merchants' Bank*, 218 U.S. 281 (1910).

pose not authorized by its charter is not void but voidable, and the sovereign alone can object. Neither the grantor nor his heirs nor third persons can impugn it upon the ground that the grantee has exceeded its powers." This decision is in accord with the weight of authority. The Supreme Court of Illinois stated the general rule to be as follows: That where a corporation is incompetent by its charter to take a title to real estate, a conveyance to it is not void, but only voidable, and the sovereign state alone can object.²² In other words, the conveyance is valid until attacked by the state in a direct proceeding through its attorney general. This rule recognizes the authority of the state which has created the corporation, to which the corporation is subject, and also has the effect of assuring the security of title to Real Estate and avoids many injurious consequences which may arise. The title of the corporation to the Real Estate and its right to enjoy the same cannot be inquired into collaterally in an action between the corporation and a private party. It can be questioned by the state only.

RECISSION OF ULTRA VIRES CONTRACTS

In a leading federal case,²³ a railroad corporation leased its entire railroad property and franchises to another railroad corporation for a term of nine hundred and ninety-nine years in consideration of the payment by the latter to the former of a certain portion of the gross receipts.

The contract was fully executed by the actual transfer of the railroad property. The former corporation held the property and paid the stipulated consideration, from time, for seventeen years. Then, for the first time, the lessor corporation became dissatisfied, brought suit in equity to cancel and set aside the instrument as beyond the corporate powers of both corporations. The United States Supreme Court, though conceding that the contract was ultra vires, decided that no suit could be maintained to set aside and cancel the contract. The parties, declared the court, should be left where they have placed themselves.

But the maxim that where both parties are equally to blame, the condition and position of the defendant are the better, was resorted to in this case. This decision seems open to criticism because it forbids a corporation to renounce that portion of an ultra vires contract which remains unexecuted. But some writers defend this decision on

²² *Hamshier v. Hamsher*, 132 Illinois 273, 23 N.E. 1123 (1890).

²³ *St. Louis, Vandalia and T. H. R. Company v. Terre Haute and I. R. Company*, 145 U.S. 393 (1892).

the ground that the court should not interfere to afford affirmative release either to enforce or to set aside this case; it should be noted that the reasoning of the decision is extremely confusing and apparently fails to distinguish between illegal and ultra vires contracts, although the court repeatedly refers to the rules which govern illegal agreements.

On the other hand, in a well known Wisconsin case,²⁴ an action was brought by a corporation engaged in the business of a common carrier, upon a contract for the sale of wheat to be delivered to the plaintiff's ship. One thousand dollars had been paid on account. The contract was repudiated as ultra vires, and the plaintiff sought judgment for the one thousand dollars paid on account, and for damages for breach of the contract. The plaintiff was not entitled to damages, said the court, but was entitled to the return of the consideration paid. Consequently Wisconsin courts recognize the right of rescission.

In general, it might be said that a corporation should be permitted to withdraw from an agreement which is ultra vires. The court interferes only to the extent of preventing the consummation of an unauthorized agreement.²⁵

DIRECTORS' LIABILITY FOR UNAUTHORIZED OR ILLEGAL ACTS

The directors of a corporation owe to it certain well defined duties. Some of the more important duties may be enumerated as follows: The duty of obedience, the duty of diligence, and the duty of loyalty. The first and most important is the duty of obedience, which means that the directors must keep within the scope of their chartered powers. They are liable to the corporation for all ultra vires acts performed by them. The stockholders may resort to injunction proceedings to enjoin the performance of such acts where they have not yet been performed. Where they already have been carried out, the remedy of the stockholders is to hold the directors liable in equity and compel them to account, or to seek a rescission. Just as an agent must keep within the scope of the authority vested in him by his principal, so must the directors of a corporation keep within the scope of the authority vested in them. For instance, the rule of law that dividends may not be paid out of capital is well settled; consequently, the directors would be personally liable if they were disobedient and ordered the payment of dividends out of the capital stock.

²⁴ *Northwestern Union Packet Company v. Shaw*, 37 Wis. 655 (1876).

²⁵ *McCutcheon v. Merz Capsule Company*, 71 Fed. 787 (1896).

MODERN TENDENCIES

Within recent years, some of the progressive jurisdictions have insisted that the question of ultra vires is closely related to the rule that only a state can inquire into the validity of a corporate existence by a quo warranto proceeding. When the state grants the charter to a corporation with definite, specified powers, it should have the right to inquire into all ultra vires contracts because it is a direct offense against the sovereign of the state. If the state does not interfere, why should private persons be permitted to raise the issue collaterally. If this doctrine is adopted, it will protect all executory ultra vires contracts from collateral attack as well as any other.

Only one leading case has been decided upon this question, which is a Kansas case.²⁶ In this case Judge Mason said: "The court is convinced of the soundness of the view that neither party to even an executory contract should be allowed to defeat its enforcement by the plea of ultra vires. The doctrine is logical in theory, simple in application, and just in results." If this view gains ground it will mean that the question of want of corporate power, just like the question of legality of corporate organization, may only be raised by the sovereign state. If the state is satisfied with the construction upon which the corporation acts, and it does not intervene, and no question of public policy is involved, there is no reason why the issue should be open to question by someone who has dealt with the corporation. It is my opinion that the above court is proceeding in the proper direction.

²⁶ *Harris v. Independent Gas Co.*, 76 Kas. 750, 92 Pac. 1123 (1907).